

## Internal Revenue Service

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 , ID No.

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Date:  
March 30, 2016

### Legend:

Grantor	=
Son	=
Trust	=
Grandson	=
Grandson's Family Trust	=
Great-Grandsons' Trust	=
Great-Granddaughters' Trust	=
Great-Grandson	=
Court Order	=
Date 1	=
Date 2	=
Date 3	=
Date 4	=
Date 5	=
Date 6	=
Date 7	=
A	=
B	=
C	=
D	=
E	=
F	=
G	=

Dear \_\_\_\_\_ :

This letter responds to the letter from your authorized representatives dated September 28, 2015, requesting rulings respecting the federal income, gift, and generation-skipping transfer (GST) tax consequences of the reallocation of property from one trust to another trust pursuant to a settlement agreement.

The facts submitted and the representations made are as follows. On Date 1, a date prior to September 25, 1985, Grantor and her son (Son) created an irrevocable trust (Trust) for the benefit of Son, Son's wife, Son's children, and the lawful issue of Son's children.

Article IV of Trust provides that during Son's lifetime, Son is to receive all of the net income of Trust at least annually. After Son's death, all of the net income of Trust is to be distributed in amounts set forth in Trust to Son's wife and Son's children. In the event of the death of a child of Son who is survived by lawful issue, the lawful issue are to receive the net income allocated to their deceased parent.

Article VI provides that Trust terminates upon the death of the last to die of a group of named persons. Article VII provides that upon termination, the trust corpus is to be distributed among the then living lawful children of Son born after the creation of Trust, and the then living lawful issue of the lawful children of Son born after the creation of Trust, per stirpes.

Trust was partitioned after litigation pursuant to a settlement agreement and Court Order dated Date 2, a date after September 25, 1985, into six separate successor family trusts for the benefit of the sons of Son and their respective lawful issue. One of the successor trusts is for the benefit of Grandson (Grandson's Family Trust). On Date 3, the Service issued a private letter ruling that concluded that this partition did not cause Trust or any of the successor trusts, including Grandson's Family Trust, to be subject to income, gift, or GST taxes.

Grandson has sons and daughters. Litigation ensued regarding whether the daughters were the lawful issue of Grandson. This litigation ended with Settlement Agreement dated Date 4 and Court Order dated Date 5. Pursuant to the Date 4 Settlement Agreement and the Date 5 Court Order, Grandson's Family Trust was partitioned into two trusts, one for the benefit of Grandson's sons (Great-Grandsons' Trust) and one for the benefit of Grandson's daughters (Great-Granddaughters' Trust). On Date 6, the Service issued a private letter ruling that concluded that this partition did not cause Grandson's Family Trust or the two successor trusts to be subject to income, gift, or GST taxes.

On Date 7, Great-Grandson died without leaving lawful issue. Paragraph 2(b)(1) of Attachment IX to the Date 4 Settlement Agreement provides that in the event a son or

daughter dies without leaving lawful issue prior to the termination of the trusts (Great-Grandsons' Trust and Great-Granddaughters' Trust), the assets and liabilities of the trusts are to be reallocated to reflect new partition ratios between the trusts.

Pursuant to Paragraph 2(c) of Attachment IX to the Date 4 Settlement Agreement, it is represented that the adjustment in assets and liabilities will be accomplished by the reallocation in kind of a proportionate interest in each separate asset and related liabilities of Great-Grandsons' Trust, in order to replicate the original partition process of the assets and liabilities of Grandson's Family Trust between Great-Grandsons' Trust and Great-Granddaughters' Trust, or to the extent that a reallocation in kind is not possible, by the reallocation of cash.

Prior to the death of Great-Grandson, the partition ratios between Great-Grandsons' Trust and Great-Granddaughters' Trust were A and B, respectively. As a result of the death of Great-Grandson without leaving lawful issue and under the Date 4 Settlement Agreement, Great-Grandsons' share of the assets and liabilities from Great-Grandsons' Trust is to be reallocated to reflect the new partition ratios of C and D. Great-Grandson's contingent remainder interest equals E percent of Great-Grandsons' Trust, one half of which will be transferred to Great-Granddaughters' Trust..

In certain cases it may not be possible or feasible to divide an asset in Great-Grandsons' Trust as part of the reallocation. Paragraph 1(b) of Attachment IX to the Date 4 Settlement Agreement provides that the trustees of Great-Grandsons' Trust will contribute the reallocated assets that are incapable of being divided to an LLC in exchange for 100 percent of the interest in the LLC. The LLC will assume or take the transferred assets subject to any existing liabilities. The LLC will not elect to be classified as an association and, therefore, as a single member LLC will be disregarded as an entity separate from its owner for federal tax purposes. Pursuant to the Date 4 Settlement Agreement, the LLC interests will then be partitioned such that Great-Grandsons' Trust owns F percent of the total ownership interests in the LLC and Great-Granddaughters' Trust owns G percent of the total ownership interests in the LLC. The LLC's Operating Agreement will provide that at such time as the LLC assets become divisible, the LLC will be liquidated and the assets transferred outright to Great-Grandsons' Trust and to Great-Granddaughters' Trust.

It is represented that no additions, constructive or actual, have been made to Trust, Grandson's Trust, Great-Grandsons' Trust, or Great-Granddaughters' Trust while they existed or since their creation.

The following rulings have been requested.

1. The reallocation of assets and liabilities from Great-Grandsons' Trust to Great-Granddaughters' Trust as a consequence of the death without lawful issue of Great-Grandson, including the transfer of certain non-divisible assets by Great-

Grandsons' Trust to an LLC, in compliance with the Date 4 Settlement Agreement (Attachment IX) and the Date 5 Court Order, will not cause Great-Grandsons' Trust or Great-Granddaughters' Trust to be subject to GST tax under § 2601.

2. The reallocation of assets and liabilities from Great-Grandsons' Trust to Great-Granddaughters' Trust as a consequence of the death without lawful issue of Great-Grandson, including the transfer of certain non-divisible assets by Great-Grandsons' Trust to an LLC, in compliance with the Date 4 Settlement Agreement (Attachment IX) and the Date 5 Court Order, will not give rise to a gift under § 2501 by any of the parties to the Date 4 Settlement Agreement.

3. The reallocation of assets and liabilities from Great-Grandsons' Trust to Great-Granddaughters' Trust as a consequence of the death without lawful issue of Great-Grandson, not including the transfer of certain non-divisible assets by Great-Grandsons' Trust to an LLC, in compliance with the Date 4 Settlement Agreement (Attachment IX) and the Date 5 Court Order, will not cause a taxable sale, exchange or disposition of an asset, whether or not capital, by any of the parties to the Date 4 Settlement Agreement.

4. The transfer by Great-Grandsons' Trust of certain non-divisible assets to an LLC as a result of the partition of certain assets from Great-Grandsons' Trust to Great-Granddaughters' Trust, in compliance with the Date 4 Settlement Agreement (Attachment IX) and the Date 5 Court Order, will not cause any party to recognize income under § 61 and will not cause a taxable sale, exchange or disposition of an asset, whether or not capital, by any of the parties to the Date 4 Settlement Agreement.

5. No gain or loss will be recognized by Great-Grandsons' Trust on the transfer of assets to an LLC in exchange for all of the ownership interest of the LLC and the assumption by the LLC of, or taking of the transferred assets subject to, any existing liabilities.

#### Ruling Request 1

Section 2601 imposes a tax on every GST made after October 26, 1986. Section 2611(a) defines a GST as (1) a taxable distribution, (2) a taxable termination, and (3) a direct skip.

Under section 1433(a) of the Tax Reform Act of 1986 (Act) and § 26.2601-1(a) of the Generation-Skipping Transfer Tax Regulations, the GST tax is generally applicable to GSTs made after October 22, 1986. However, under § 1433(b)(2)(A) of the Act and § 26.2601-1(b)(1)(i), the tax does not apply to a transfer under a trust (as defined in § 2652(b)) that was irrevocable on September 25, 1985, but only to the extent that such transfer is not made out of corpus added to the trust after September 25, 1985 (or out of income attributable to corpus so added).

Section 26.2601-1(b)(4) provides rules for determining when a modification, judicial construction, settlement agreement, or trustee action with respect to a trust that is exempt from the GST tax under § 26.2601-1(b)(1), (b)(2), or (b)(3) will not cause the trust to lose its exempt status. In general, unless specifically provided otherwise, the rules of § 26.2601-1(b)(4) are applicable only for purposes of determining whether an exempt trust retains its exempt status for GST tax purposes. They do not apply in determining, for example, whether the transaction results in a gift subject to gift tax, or may cause the trust to be included in the gross estate of a beneficiary, or may result in the realization of capital gain for purposes of § 1001.

Section 26.2601-1(b)(4)(i)(B) provides that a court-approved settlement of a bona fide issue regarding the administration of a trust or the construction of terms of the governing instrument will not cause an exempt trust to be subject to the provisions of chapter 13, if (1) the settlement is the product of arm's length negotiations; and (2) the settlement is within the range of reasonable outcomes under the governing instrument and applicable state law addressing the issues resolved by the settlement. A settlement that results in a compromise between the positions of the litigating parties and reflects the parties' assessments of the relative strengths of their positions is a settlement that is within the range of reasonable outcomes.

In this case, Trust was created and irrevocable before September 25, 1985. It is represented that no additions, constructive or actual, have been made to Trust, Grandson's Family Trust, Great-Grandsons' Trust, or Great-Granddaughters' Trust while they existed or since their creation. Consequently, Great-Grandsons' Trust and Great-Granddaughters' Trust are currently exempt from GST tax.

In the Date 6 private letter ruling, the Service ruled that the partition of Grandson's Family Trust into Great-Grandsons' Trust and Great-Granddaughters' Trust pursuant to the Date 4 Settlement Agreement and the Date 5 Court Order does not cause Grandson's Family Trust or the two successor trusts to be subject to income, gift, or GST taxes. The reallocation of assets and liabilities from Great-Grandsons' Trust to Great-Granddaughters' Trust is made pursuant to the Date 4 Settlement Agreement and the Date 5 Court Order.

Accordingly, based upon the facts submitted and the representations made, we conclude that the reallocation of assets and liabilities from Great-Grandsons' Trust to Great-Granddaughters' Trust as a consequence of the death without lawful issue of Great-Grandson, including the transfer of certain non-divisible assets by Great-Grandsons' Trust to an LLC, in compliance with the Date 4 Settlement Agreement (Attachment IX) and the Date 5 Court Order, will not cause Great-Grandsons' Trust and Great-Granddaughters' Trust to be subject to GST tax under § 2601.

Ruling Request 2

Section 2501 imposes a tax for each calendar year on the transfer of property by gift during such calendar year by any individual.

Section 2511 provides that the tax imposed by § 2501 applies whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property transferred is real or personal, tangible or intangible.

Section 25.2511-1(c)(1) of the Gift Tax Regulations provides that any transaction in which an interest in property is gratuitously passed or conferred upon another, regardless of the means or device employed, constitutes a gift subject to tax.

Section 2512(a) provides that, if the gift is made in property, the value thereof at the date of the gift shall be considered the amount of the gift.

Section 2512(b) provides that where property is transferred for less than an adequate and full consideration in money or money's worth, then the amount by which the value of the property exceeded the value of the consideration shall be deemed a gift.

Section 25.2512-8 provides that transfers reached by the gift tax are not confined to those only which, being without a valuable consideration, accord with the common law concept of gifts, but embrace as well sales, exchanges, and other dispositions of property for a consideration to the extent that the value of the property transferred by the donor exceeds the value in money or money's worth of the consideration given therefor. However, a sale, exchange, or other transfer of property made in the ordinary course of business (a transaction which is bona fide, at arm's length, and free from any donative intent), will be considered as made for an adequate and full consideration in money or money's worth. A consideration not reducible to a value in money or money's worth, as love and affection, promise of marriage, etc., is to be wholly disregarded, and the entire value of the property transferred constitutes the amount of the gift. Similarly, a relinquishment or promised relinquishment of dower or curtesy, or of a statutory estate created in lieu of dower or curtesy, or of other marital rights in the spouse's property or estate, shall not be considered to any extent a consideration "in money or money's worth."

On Date 6, the Service issued a private letter ruling that the partition of Grandson's Family Trust into Great-Grandsons' Trust and Great-Granddaughters' Trust pursuant to the Date 4 Settlement Agreement and the Date 5 Court Order did not cause Grandson's Family Trust, Great-Grandsons' Trust, or Great-Granddaughters' Trust to be subject to income, gift, or GST taxes.

In this case, the reallocation of assets and liabilities from Great-Grandsons' Trust to Great-Granddaughters' Trust is made pursuant to the Date 4 Settlement Agreement and the Date 5 Court Order. After the proposed reallocation of assets and liabilities from Great-Grandsons' Trust to Great-Granddaughters' Trust, including the transfer of certain non-divisible assets by Great-Grandsons' Trust to an LLC, each beneficiary of Great-Grandsons' Trust and Great-Granddaughters' Trust will have the same beneficial interest as he or she had under Trust and the settlement agreement and Court Order dated Date 2. Because the beneficial interests of the beneficiaries are the same, both before and after the proposed reallocation, no transfer of property will be deemed to occur as a result of the reallocation.

Accordingly, based on the facts submitted and the representations made, we conclude that the reallocation of assets and liabilities from Great-Grandsons' Trust to Great-Granddaughters' Trust as a consequence of the death without lawful issue of Great-Grandson, including the transfer of certain non-divisible assets by Great-Grandsons' Trust to an LLC, in compliance with the Date 4 Settlement Agreement (Attachment IX) and the Date 5 Court Order, will not give rise to a gift under § 2501 by any of the parties to the Date 4 Settlement Agreement.

### Ruling Request 3

Section 61(a)(3) provides that gross income includes gains derived from dealings in property.

Section 1001(a) provides that the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in § 1011 for determining gain, and the loss shall be the excess of the adjusted basis provided in § 1011 for determining loss over the amount realized.

Section 1001(b) states that the amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received. Under § 1001(c), except as otherwise provided in subtitle A, the entire amount of gain or loss, determined under § 1001, on the sale or exchange of property shall be recognized.

Section 1.1001-1(a) of the Income Tax Regulations provides that the gain or loss realized from the conversion of property into cash, or from the exchange of property for other property differing materially either in kind or in extent, is treated as income or loss sustained.

Section 1.1001-1(h)(1) provides that the severance of a trust (including without limitation a severance that meets the requirements of § 26.2642-6 or of § 26.2654-1(b) of this chapter) is not an exchange of property for other property differing materially either in kind or in extent if – (i) an applicable state statute or the governing instrument

authorizes or directs the trustee to sever the trust, and (ii) any non-pro rata funding of the separate trusts resulting from the severance whether mandatory or in the discretion of the trustee, is authorized by an applicable state statute or governing instrument.

A pro rata partition of jointly owned property is not a sale or other disposition of property where the co-owners of the joint property sever their joint interests but do not acquire a new or additional interest as a result of the transaction. Thus, neither gain nor loss is realized on a partition. See Rev. Rul. 56-437, 1956-2 C.B. 507.

*Cottage Savings Ass'n v. Commissioner*, 499 U.S. 554 (1991), concerns the issue of when a sale or exchange has taken place that results in the realization of gain or loss under § 1001. In *Cottage Savings*, a financial institution exchanged its interests in one group of residential mortgage loans for another lender's interests in a different group of residential mortgage loans. The two groups of mortgages were considered "substantially identical" by the agency that regulated the financial institution.

The Supreme Court of the United States in *Cottage Savings*, 499 U.S. at 560-61, concluded that § 1.1001-1 reasonably interprets § 1001(a) and stated that an exchange of property gives rise to a realization event under § 1001(a) if the properties exchanged are "materially different." In defining what constitutes a "material difference" for purposes of § 1001(a), the Court stated that properties are "different" in the sense that is "material" to the Internal Revenue Code (Code) so long as their respective possessors enjoy legal entitlements that are different in kind or extent. *Cottage Savings*, 499 U.S. at 564-65. The Court held that mortgage loans made to different obligors and secured by different homes did embody distinct legal entitlements, and that the taxpayer realized losses when it exchanged interests in the loans. *Cottage Savings*, 499 U.S. at 566.

In this case, the reallocation of assets and liabilities from Great-Grandsons' Trust to Great-Granddaughters' Trust is authorized by Paragraph 2(b)(1) and Paragraph 2(c) of Attachment IX to the Date 4 Settlement Agreement, which the court approved in the Date 5 Court Order as the governing instrument of the successor trusts. See § 1.1001-1(h)(1). The reallocation and distribution of assets and liabilities from Great-Grandsons' Trust to Great-Granddaughters' Trust, except for certain non-divisible assets, will be done in kind so that a proportionate interest in each separate asset and related liability in the reallocating trust, will replicate the original partition process. This is the functional equivalent of a pro rata division and distribution of assets and liabilities between the two successive trusts so that the reallocation in this case does not result in a material difference in kind or extent of the legal entitlements enjoyed by the successor trusts' beneficiaries within the meaning of *Cottage Savings*. Consequently, pursuant to Rev. Rul. 56-437, no gain or loss will be realized or recognized by Great-Grandsons' Trust or Great-Granddaughters' Trusts, or the beneficiaries of any of the successor trusts, from the pro rata reallocation and distribution of assets and liabilities as a result of this reallocation under §§ 61(a)(3) and 1001(a).



Accordingly, based upon the facts submitted and the representations made, we conclude that the reallocation of assets and liabilities from Great-Grandsons' Trust to Great-Granddaughters' Trust as a consequence of the death without lawful issue of Great-Grandson, not including the transfer of certain non-divisible assets by Great-Grandsons' Trust to an LLC, in compliance with the Date 4 Settlement Agreement (Attachment IX) and the Date 5 Court Order, will not result in a sale or exchange, or other disposition, of any property for purposes of § 1001(a), and thus no gain or loss will be recognized by Great-Grandsons' Trust and Great-Granddaughters' Trusts or the beneficiaries or these trusts on the division and reallocation of assets and liabilities for purposes of § 61(a)(3) or § 1001(c).

#### Ruling Request 4

Section 61(a)(3) provides that gross income includes gains derived from dealings in property.

Section 721(a) provides that, as a general rule, no gain or loss shall be recognized to a partnership or to any of its partners in the case of a contribution of property to the partnership in exchange for an interest in the partnership.

Section 1001(a) provides that the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in § 1001 for determining gain, and the loss shall be the excess of the adjusted basis provided in § 1001 for determining loss over the amount realized.

Section 1.1001-1(a) provides that except as otherwise provided in subtitle A of the Code, the gain or loss realized from the exchange of property for other property differing materially either in kind or in extent, is treated as income or as loss sustained.

In this case, after the partition of Great-Grandsons' Trust of assets being contributed to the LLC, Great-Grandsons' Trust will continue to be subject to the dispositive provisions of Trust and the Date 4 Settlement Agreement (Attachment IX) and the Date 5 Court Order. Therefore, under *Cottage Savings*, the properties exchanged are not materially different, and there would be no realization of gain or loss. The distribution of ownership interests in the LLC by Great-Grandsons' Trust, as part of the partition of Great-Grandsons' Trust, and the conversion of the LLC from a disregarded entity to an entity taxed as a partnership will not give rise to income under § 61, and will not cause a capital gain or loss to be realized. Under § 721(a), no gain or loss is recognized by either of the trusts as a result of the conversion of the disregarded entity to a partnership. Any distribution of money or other property from the partnership to either trust is subject to the disguised sale rules under § 707(a)(2)(B).

As a result of the partition of assets being contributed to the LLC, Great-Grandsons' Trust will receive F percent of the equity interest in the LLC and Great-Granddaughters' Trust will receive G percent of the equity interest in the LLC. Therefore, this partition will cause the LLC to convert from a disregarded entity to a partnership, as described in Situation 1 in Rev. Rul. 99-5, 1999-1 C.B. 434. Under Rev. Rul. 99-5, Great-Grandsons' Trust will be treated as owning an F percent interest in each of the LLC's assets and Great-Granddaughters' Trust will be treated as owning a G percent interest in each of the LLC's assets. Both of the trusts will be treated as contributing the trusts' respective interests in those assets to a partnership in exchange for ownership interests in the partnership.

Accordingly, based upon the facts submitted and the representations made, we conclude that the transfer of certain non-divisible assets by Great-Grandsons' Trust to the LLC, the distribution of ownership interests in the LLC by Great-Grandsons' Trust to both Great-Grandsons' Trust and Great-Granddaughters' Trust, and the conversion of the LLC from a disregarded entity to an entity taxed as a partnership in compliance with the Date 4 Settlement Agreement (Attachment IX) and the Date 5 Court Order, will not cause any party to the Date 4 Settlement Agreement to realize income under § 61 and will not constitute a taxable sale, exchange, or disposition of an asset, whether or not capital, by the parties to the Date 4 Settlement Agreement.

#### Ruling Request 5

Section 301.7701-3(a) of the Procedure and Administration Regulations provides, in part, that a business entity that is not classified as a corporation under § 301.7701-2(b)(1), (3), (4), (5), (6), (7), or (8) (an eligible entity) can elect its classification for federal tax purposes as provided in § 301.7701-3. An eligible entity with a single owner can elect to be classified as an association or to be disregarded as an entity separate from its owner.

Section 301.7701-3(b)(1)(ii) provides that, except as provided in § 301.7701-3(b)(3), unless the entity elects otherwise, a domestic eligible entity is disregarded as an entity separate from its owner if it has a single owner.

In this case, the contribution of non-divisible assets to the LLC in exchange for the ownership interest in the LLC will be disregarded for federal tax purposes because it is represented that the LLC will not elect to be classified as an association, and therefore, will be disregarded as an entity separate from its owner for federal tax purposes.

Accordingly, based upon the facts submitted and the representations made, we conclude that no gain or loss will be recognized by Great-Grandsons' Trust upon the transfer of assets to the LLC in exchange for all of the ownership interest of the LLC and

the assumption by the LLC of, or taking of the transferred assets subject to, certain existing liabilities.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Melissa C. Liquerman

Melissa C. Liquerman  
Chief, Branch 4  
Office of the Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosures: Copy for § 6110 purposes

cc: